STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**06/12/00**	Bill No:	**AB 2612**
Tax:	**Property Tax** **Sales and Use**	Author:	**Brewer &** **Maldonado**
Board Position:	**Pipelines– Support** **Interest- Board-** **sponsored**	Related Bills:	**AB 464 (1999)** **AB 1208 (1999)** **AB 1286 (1996)**

BILL SUMMARY:

This bill would do the following:

- Extend, from January 1, 2001 to January 1, 2011, specified property tax assessment procedures for intercounty pipeline rights-of-way.
- Specify the Legislature's intent to revise the interest calculation provisions in the tax and fee programs the Board administers so that the same rate of interest is applied to both underpayments and overpayments of tax.

ANALYSIS:

Intercounty Pipeline Rights-of-Way

Current Law:

Commencing in 1993, assessors were required to begin to assess intercounty pipeline rights-of-ways after a court ruling held that the prior assessment of these rights by the Board of Equalization was outside of its jurisdiction. The property tax collected on the Board assessments were to be refunded and county assessors were to instead levy escape assessments retroactively to the 1984-85 tax year based on their own determinations as to the value of these interests. Existing law, Section 401.10 of the Revenue and Taxation Code, reflects an agreement reached in 1996 between county assessors and intercounty pipeline rights-of-way owners to set forth the assessment methodology for this assessment transition. These procedures have been used to determine the assessed value of intercounty pipeline rights-of-way for the 1984-85 through 2000-01 tax years. When this methodology is followed, the value so determined is rebuttably presumed to be correct. Section 401.10 is repealed by its own provisions on January 1, 2001. The agreement also sets forth, in Section 401.11, the treatment of tax refunds and escape assessments, as applicable for purposes of the assessment transition. Section 401.11 was repealed by its own provisions on January 1, 2000.

Proposed Law:

This provision would extend the assessment methodology of Section 401.10 to January 1, 2011.

<u>In General:</u>

Intercounty pipeline rights-of-way, for tax years 1984-85 through 2000-01, may be assessed according to a prescribed dollars-per-mile schedule that determines value according to the "density classification" of the property as follows: $20,000 per mile for high density, $12,000 per mile for transitional density, and $9,000 per mile for low density. When a county assessor uses this methodology to value pipeline rights-of-way the property owner is precluded from challenging the legality of the assessment. If the methodology is not followed, then the property owner may challenge the legality of the assessment and the assessor's presumption of correctness is negated.

<u>Background:</u>

Intercounty pipeline rights-of-way were assessed by the Board from 1982 until 1993. In 1993 an appellate court ruled that, while the pipelines themselves are properly assessed by the Board, the rights-of-way through which the pipelines run were outside of the Board's assessment jurisdiction. Instead, county assessors were directed to make these assessments. (*Southern Pacific Pipe Lines, Inc*. v. *State Board of Equalization* 14 Cal.App.4th 42) A pivotal issue giving rise to this litigation is that property assessed by the Board is not subject to the assessment limitations of Proposition 13. Board assessed property is reassessed each year at current fair market value, whereas property assessed by the county assessor is assessed at the base year value (year of acquisition), increased by the annual 2%-maximum inflation factor. Pipeline operators naturally preferred assessment at the local level.

As a result of the court case, taxes collected based on Board assessments were to be refunded. County assessors were to value these interests and levy escape assessments for the tax years 1984-85 and forward. (In practice, whether the property is valued by the Board or the county assessor, the county collects the taxes as well as distributes the resulting revenue to other local governments.) The intercounty nature of these interests made the valuation process difficult under traditional local assessment procedures. In addition, uniform valuation of these interests by the 58 local counties was lacking. To avoid protracted litigation over these assessments, pipeline owners and counties negotiated the assessment methodology outlined in Section 401.10 and escape assessment/refund process of 401.11, which was subsequently codified by AB 1286 (Ch. 801, Takasugi, Stats. 1998).

COMMENTS:

Sponsor and Purpose. This provision is sponsored by the California Manufacturers and Technology Association for the purpose of extending the assessment methodology provision which has been proven to work well.

COST ESTIMATE:

This provision has no direct cost to the Board of Equalization.

REVENUE ESTIMATE:

Counties report that the statewide total assessed value for the 1999-2000 roll year for intercounty pipeline rights-of-way amounted to $319,829,000. The current methodology is the result of an agreement between taxpayers and counties to establish the standards of valuation for intercounty pipeline rights-of-way. This proposal would extend the use of this methodology for an additional ten years. Although the revenues that would result in the absence of these standards can not be determined, it is reasonable to conclude that any net revenue impact from extending the sunset date would be insignificant.

Interest Equalization

Current Law:

Under existing law, persons who are late in payment of their tax obligations are required to pay a penalty of 10 percent of the tax, plus interest on the unpaid tax from the date the tax was due to the date upon which it was paid. Persons who have overpaid their tax to the state are granted credit interest on the overpayment (when it is determined that the overpayment was not intentional or a result of carelessness) from the first day of the calendar month following the month during which the overpayment was made to the last day of the month following the date upon which the refund is approved by the Board.

Prior to July 1, 1991, there was no difference between the rate of interest paid by the Board to taxpayers on overpayments of tax and the rate of interest paid by taxpayers to the Board on underpayments of tax. However, AB 2181 and SB 179 (Chs. 85 and 88, respectively, Stats. of 1991) significantly changed the computation of *credit* interest on overpayments of tax. Those measures provided that interest on underpayments is calculated based on specified provisions of the Internal Revenue Code, plus three percentage points. As of January 1, 2000, that rate is set at 11 percent. Interest on overpayments of tax is based on the bond equivalent rate of 13-week treasury bills auctioned. Effective January 1, 2000, that rate is 5 percent. Therefore, under current law, there is a 6 percent difference in the rate of interest paid on overpayments and the rate of interest assessed on underpayments.

Proposed Law:

This bill would state the intent of the Legislature to do both of the following:

(a) Eliminate the requirement that the rate of interest accruing on overpayments of sales and use tax be based on the rate of 13-week treasury bills issued by the federal government.

(b) Require, subject to certain modifications, that the rate of interest accruing on both overpayments and underpayments of sales and use tax be determined in accordance with the rate of interest determined under Section 6621(a) (2) of the Internal Revenue Code for underpayments of federal taxes.

Background:

The July 1, 1991 legislation that revised the method of computing interest was proposed by the Department of Finance as part of the Governor's package to resolve the budget deficit. This legislation was prompted by a 1990 landmark decision involving new sales and use tax issues for U. S. Government contractors (Aerospace) in California. As a result of that decision, U.S. Government contractors would be entitled to refunds of overpayments of taxes previously paid to the Board on specified transactions with the U. S. Government. Because of the potentially significant amount of tax and the period of time the overpayments occurred, it was recognized that these refunds would include a very significant amount of credit interest. With the reduced rate of interest, naturally, the state would not lose such a significant amount of revenue.

Provisions similar to Section 1 of this bill have been introduced in the past: AB 2972 (Mays, 1992 Legislative Session), AB 2083 (Takasugi, 1993 Legislative Session), AB 3487 (Andal, 1994 Legislative Session), AB 1189 (Takasugi, 1995 Legislative Session), AB 222 (Takasugi, 1997-98 Legislative Session), AB 464 (Maldonado, 1999 Legislative Session) and AB 1208 (Assembly Revenue and Taxation Committee).

The interest equalization provisions were amended out of Assembly Bill 1208 on January 3, 2000 in the Senate Appropriations Committee, and AB 464 was held in suspense in the Assembly Appropriations Committee. AB 222 was amended early in 1998 to instead provide for a one percent increase in the credit interest rate, and, with that amendment, was held in the Senate Appropriations Committee. AB 2083 and AB 3487 both failed passage in the Assembly Revenue and Taxation Committee; and AB 1189 failed passage in the Senate Appropriations Committee. AB 2972 passed the Legislature, but was vetoed by the Governor. In his veto message, Governor Wilson stated, “Legislation enacted last year (Chapter 85, Statutes of 1991) established a separate, lower rate for state and local sales tax refund liability. Chapter 85 was enacted to minimize the impact of accruing interest as a result of the Aerospace decision. This bill would reverse that legislation, thereby reinstating the higher rate on refund liability.

“Imposing a lower rate for refunds minimizes the impact on the state in the event of large taxpayer refund liability. Imposing a higher rate on amounts owed by taxpayers serves as an incentive for taxpayers to remit those amounts in a timely manner as well as to comply with the law. I do not wish to change these incentives.”

COMMENTS:

1. **Sponsor and purpose.** This provision is sponsored by both the Board of Equalization and the California Manufacturers and Technology Association in an effort to eliminate the 6-point disparity that currently exists in the rate of interest charged on late payments and the rate of interest paid on refunds. Since the interest on U.S. government contractor refunds has been settled, it seems logical and equitable to reestablish prior law and equalize the interest rates between refunds and liabilities. This would address the concerns of many taxpayers who view this disparity as extremely unfair.

2. **Amendments.** The May 26 amendment deleted the provisions which would have amended Section 6591.5 of the Sales and Use Tax Law to require that interest paid with respect to both underpayments and overpayments of tax be calculated at the modified adjusted rate per annum determined by specified provisions of the Internal Revenue Code plus three percentage points. Since the various Special Taxes laws currently reference Section 6591.5, taxes or fees under the Special Taxes programs administered by the Board would also have benefited. As amended, this bill instead states the Legislature's intent to make the above referenced changes.

3. **Other major taxing agencies don't have such a disparity.** According to the Franchise Tax Board, its interest rate on both underpayments and overpayments is the same--currently, 8 percent compounded daily. The Internal Revenue Service has only a 1 point disparity in interest rates for corporations – currently, 8 percent is compounded daily on underpayments and 7 percent on overpayments, and no disparity for noncorporate taxpayers.

4. **The intent of this provision is not to change interest charged on late payments of taxes.** The Governor's veto message on AB 2972 (referred to above) indicates that interest provides an incentive to pay as well as to comply with the law and that he does not want to change these incentives. The intent of this bill is not to change the rate of interest charged on late payments of tax. It is only intended to address the interest rate paid on overpayments. Therefore, the incentives provided in the law to encourage prompt payment of taxes would remain intact and would not be affected if the interest rate differential was eliminated.

5. **The justification for the interest rate differential no longer exists.** The entire basis for the lower credit interest rate was to reduce the amount of interest associated with the Aerospace refunds. Since the settlement agreement on repayment of the refunds has been finalized, there is simply no justification now to have the 6-point discrepancy in the credit interest rate.

COST ESTIMATE:

Notification and programming costs attributable to any change of the credit interest rate would be absorbable.

REVENUE ESTIMATE:

Background, Methodology, and Assumptions

The Board makes Sales and Use Tax refunds of about $100 million annually to which credit interest applies. The average period for which interest is paid is three and a half years. In the long run, the amount of additional credit interest that the Board would pay, if the credit interest is raised from the current rate of 5% to the current underpayment rate of 11%, would be $21.0 million annually.

The Board also currently pays about $1,501,000 in credit interest each year for the Special Taxes programs. This interest is paid over a much shorter time period than is the case for the Sales and Use Tax refunds. In the long run, increasing the credit interest rate from the current 5% to 11% would result in increased credit interest payments of $1,801,000 annually for the Special Taxes programs.

Since a change in the interest rate would affect interest accrued only after the effective date of any legislation, the full effect of changing the credit interest rate would take a number of years to be fully realized. Increasing the rate to 11% would have a total first year effect for both programs of about $1.0 million. The full effect of $22.8 million would be felt in the fifth year.

Revenue Summary

In its present form this provision has no revenue impact. However, if the interest rate changes proposed by the intent language in this bill were enacted, the revenue reduction from increasing the credit interest rate from the current 5% rate to 11%, for the next five fiscal years, assuming a January 1, 2001 effective date, would be as follows:

Increased Credit Interest Payments

	State					
Year	Special Taxes	Sales & Use Tax	Total	Local	Transit	Total
2000-01	$ 75,050	$ 552,399	$ 627,449	$ 248,580	$ 74,021	$ 950,050
2001-02	536,071	3,945,707	4,481,778	1,775,568	528,725	6,786,071
2002-03	1,050,700	7,733,586	8,784,286	3,480,114	1,036,301	13,300,701
2003-04	1,565,329	11,521,465	13,086,794	5,184,659	1,543,876	19,815,329
2004-05	1,801,200	13,257,576	15,058,776	5,965,909	1,776,515	22,801,200

Analysis prepared by:	Sheila T. Sarem	445-6579	06/23/00
	Rose Marie Kinnee	445-6777	
Revenue estimate by:	David E. Hayes	445-0840	
	Aileen Takaha Lee		
Contact:	Margaret S. Shedd	322-2376	

sf